ANNUAL
REPORT
1978

OMEGA
HYDROCARBONS LTD.

DIRECTORS

T. Jack Hall, Calgary

Henry Higgins, Calgary

Ernest M. Braithwaite, Calgary

OFFICERS

President — T. Jack Hall

Vice President — Arthur L. Evans

Secretary — Ernest M. Braithwaite

Treasurer — Henry Higgins

Assistant Secretary — Bonnie Foote

HEAD OFFICE

Suite 630, 330 - 5th Avenue S.W.
Calgary, Alberta T2P 0L4

AUDITORS

Thorne Riddell & Co.
Chartered Accountants
1400 Bow Valley Square 2
205 - 5th Avenue S.W.
Calgary, Alberta T2P 2W4

REGISTRAR

The Canada Trust Company
239 - 8th Avenue S.W.
Calgary, Alberta T2P 1B9

TRANSFER AGENTS

The Canada Trust Company
239 - 8th Avenue S.W.
Calgary, Alberta T2P 1B9

SOLICITORS

Macleod Dixon
1500 Home Oil Tower,
Toronto Dominion Square
Calgary, Alberta T2P 2Z2

MAIN BANKERS

Toronto Dominion Bank
2 Calgary Place
340 - 5th Avenue S.W.
Calgary, Alberta T2P 2P6

Annual General Meeting

The Annual General Meeting of the shareholders of Omega Hydrocarbons Ltd. will be held at The Calgary Inn (Lakeview Room) at 4th Avenue and 3rd Street S.W., Calgary, Alberta on Tuesday, the 8th day of May, 1979 at 3:30 p.m. (local time).

TO THE SHAREHOLDERS

T. Jack Hall — President

I am pleased to report that 1978 was another successful year for Omega. As visualized in our report one year ago, the Company increased its drilling and exploration activity to an all time high while at the same time maintaining earnings and cash flow with little support from newly discovered reserves. Substantial progress was attained in proving up additional oil and gas reserves. Net proved and probable oil reserves more than doubled to a figure slightly in excess of one million barrels while net gas reserves increased more than five fold to an estimated thirty-seven billion cubic feet. At the same time, we were aggressively improving our exploration land holdings in Western Canada, in spite of intense competition for Crown and freehold leases. Omega's land position increased from 51,763 net acres to 99,627 net acres since the last reporting period and again is showing substantial improvement during the first quarter of 1979.

Development of the Company's oil and gas leases in the Provost area will continue to take priority during the summer drilling season 1979. The two producing oil wells placed on production in late 1977 have been complemented by the addition of five new oil wells, one gas well and one well awaiting recompletion. It is expected that as many as twelve to twenty wells will be drilled at Provost before year end. In addition to the Company's drilling activity, a number of wells are scheduled for drilling by other operators in the immediate area of the Company's lands which will assist in defining the size and extent of the oil accumulation. Feasibility studies for gas conservation and water-flood will be undertaken as development drilling progresses.

A significant development during the past year was the acquisition from Siebens Oil and Gas Ltd., effective August 23, 1978, of a large contiguous block of Crown P. & N.G. Leases (26,880 acres) in the Boyer area including the shallow natural gas rights over the entire spread. In addition to the shallow gas reserves estimated by D & S Consultants to be 66.1 Bcf, Proved and Probable, the purchase includes six completed shallow gas wells having a gross and net pay section of sixty feet and forty feet respectively. Subsequent to the acquisition, Omega nominated for 2.6 MMcf/d plant capacity in the recently constructed 30 MMcf/d Paddle Prairie Gas Plant which is operated by Petro-Canada. At the time of writing, the gathering system is in the final stage of completion, connecting seven wells to the gas plant.

Financing of the project was complemented by offering a forty percent interest in the shallow gas rights to Omega Oil & Gas Fund No. 2. Omega and the Limited Partners will share net revenue on the basis of 72% and 28% respectively.

The gas is under contract to TransCanada Pipelines Limited and deliveries are awaiting approval of a permit to remove gas from the province. Early approval is expected from the newly appointed members of the Alberta cabinet.

As was reported to our shareholders last year, I discussed at some length the means by which the Company would find support for its active

Left to right: Bonnie Foote, Accountant - Land   Sharon Morris, Well Records - Land   Danita Dick, Receptionist - Typist

drilling program. Since that report, Omega Oil and Gas Fund No. 1 has contributed $1,500,000 toward a successful and rewarding program. However, the amount of funds expected from a German Drilling Fund did not materialize to the anticipated extent. We were successful in placing $236,000 of German funds in the deep test in the West Pembina well which, as you may already appreciate, was barren in the primary D-2 horizon, but completed in the Blairmore zone as a flowing oil well. As a consequence of non-performance, it resulted in the cancellation of a stock option amounting to 500,000 shares. On the affirmative side, we were again successful in raising another $1,500,000 by organizing Omega Oil & Gas Fund No. 2.

Company forecasts indicate that new financing will be necessary to enable our staff to actively pursue new goals in exploration and in the development of the Provost and Boyer properties, all requiring substantial investments over the next two years. Cash flow from producing properties, notwithstanding market difficulties, should continue to show improvement. The higher volume coupled with expected price escalation should enable Omega to attain a cash flow and net earnings for 1979 which will substantially exceed the previous year. Our expected level of activity under current circumstances is not only gratifying but once again illustrates the competitive position which the Company has maintained. Omega will strive to preserve a level of efficiency in its operations which, within the framework imposed upon us, will support our reach for new horizons.

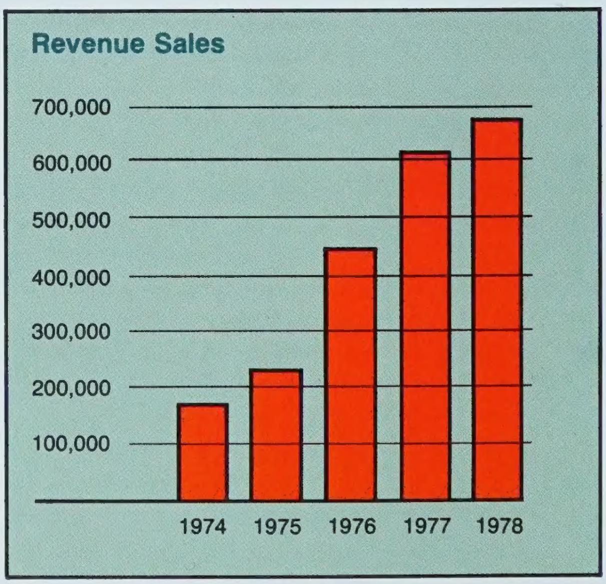
I would like to express the gratitude of the Board of Directors to the staff for their dedication and contribution to the Company's success.

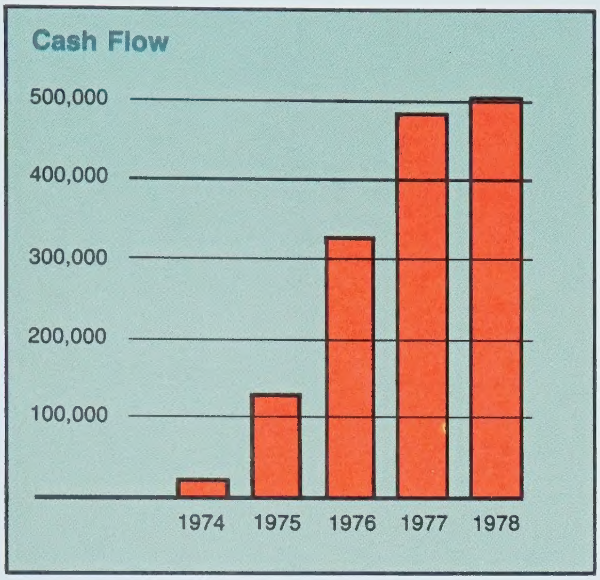
ON BEHALF OF THE BOARD

T. Jack Hall
President

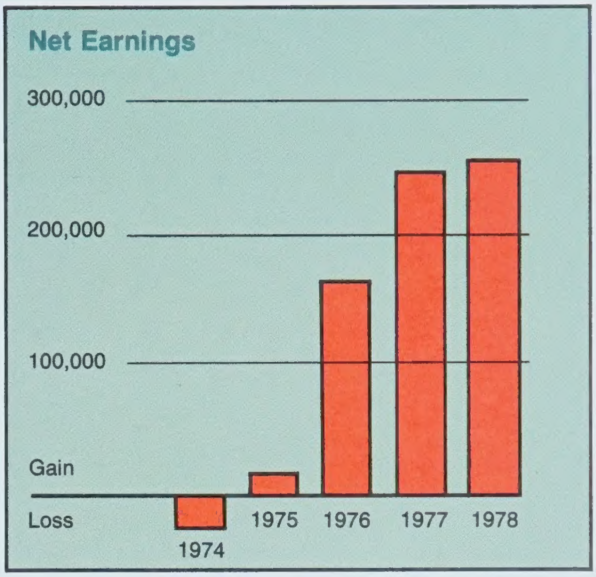
Calgary, Alberta   April 16, 1979

Art Evans, Vice President - Exploration



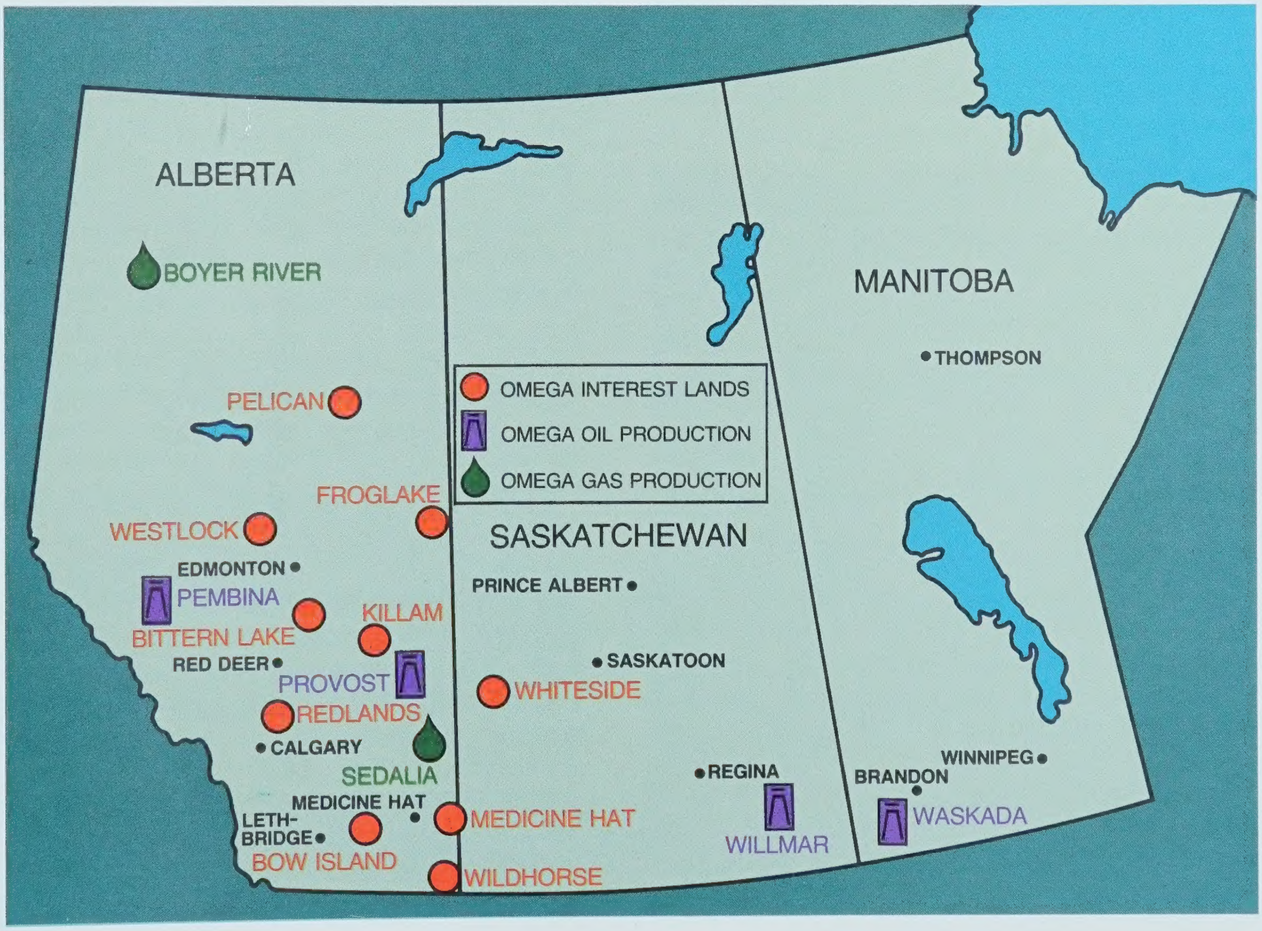


Cash Flow
500,000
400,000
300,000
200,000
100,000
1974
1975
1976
1977
1978



Net Earnings
300,000
200,000
100,000
Gain
Loss
1974
1975
1976
1977
1978

HIGHLIGHTS



ALBERTA
SASKATCHEWAN
MANITOBA
OMEGA INTEREST LANDS
OMEGA OIL PRODUCTION
OMEGA GAS PRODUCTION
BOYER RIVER
PELICAN
FROGLAKE
WESTLOCK
EDMONTON
PEMBINA
BITTERN LAKE
KILLAM
RED DEER
PROVOST
REDLANDS
CALGARY
SEDALIA
MEDICINE HAT
LETH-
BRIDGE
BOW ISLAND
MEDICINE HAT
WILDHORSE
PRINCE ALBERT
SASKATOON
WHITESIDE
REGINA
WILLMAR
THOMPSON
WINNIPEG
BRANDON
WASKADA

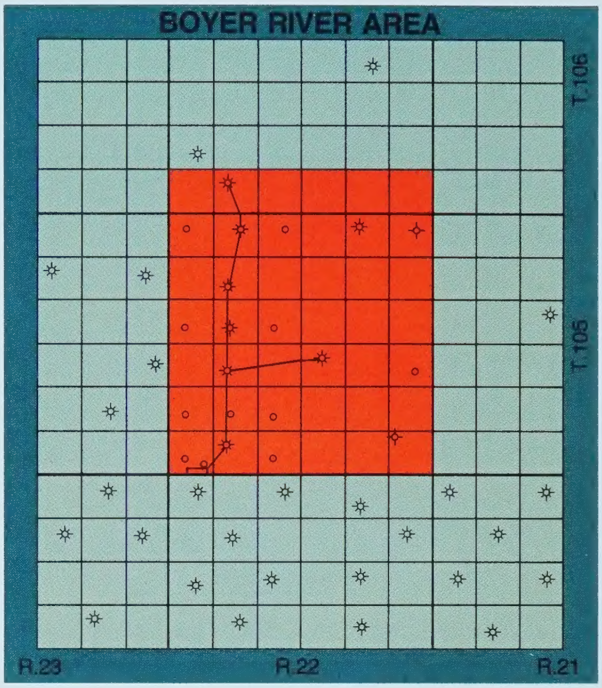
BOYER

The Company's Boyer properties are located in Twps. 105 and 106, Rge. 22, West of the 5th Meridian, Alberta. These lands comprise a total of 26,880 acres of petroleum and natural gas leases including the natural gas rights over the entire spread. The Company purchased a one hundred percent interest in the leases including six completed Lower Cretaceous gas wells and related equipment. Of particular significance to the Company is a gas purchase contract for delivery of gas immediately upon receipt by Trans-Canada Pipelines of a permit to remove gas from the province. In compliance with the terms of the contract, Omega has nominated for plant capacity in the Petro-Canada Gas Plant located on the southern portion of Omega's property. The gathering system, connecting five of the six wells purchased along with two recently drilled wells, has now been completed and is ready for gas delivery.

Financing of the Boyer property was accomplished in part by selling a 40% interest in the Cretaceous gas rights to Omega Oil & Gas Fund No. 2 to yield the Fund a 28% share of net revenue.

These lands are located on a shallow, wide spread, Basal Cretaceous gas trend where the existing well control indicates a continuous gas reservoir extending over the entire spread of land. Reserves have been calculated by D & S Consultants to be 45.9 Bcf, Proved and 66.1 Bcf, Proved plus Probable.

Initial production will be in the range of 1,300 Mcf per day until November 1, 1979; increasing to 2,600 Mcf per day until November 1, 1980. Following that date, the producing rates will be established on the basis of estimated gas reserves and deliverability of the wells connected to the gathering system which, according to present estimates, will be in the range of six to seven million cubic feet per day thus requiring a substantial drilling program, followed by an expansion of gathering and plant facilities during the 1979-1980 winter season.



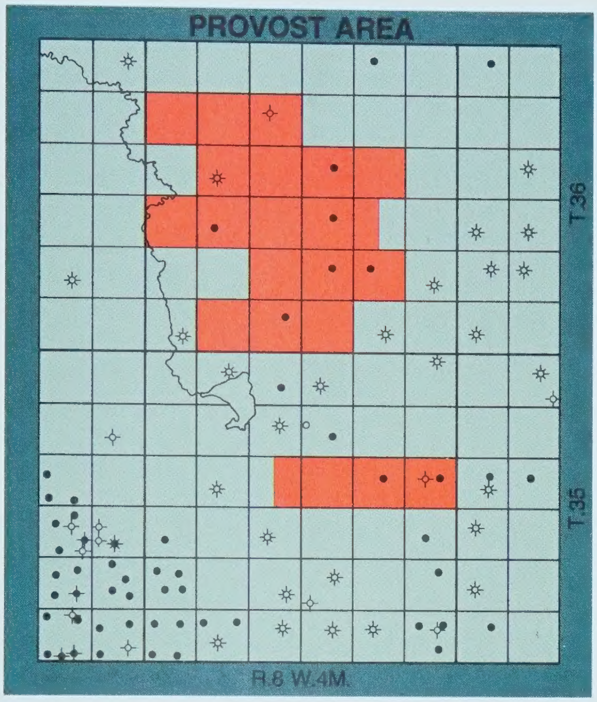
PROVOST

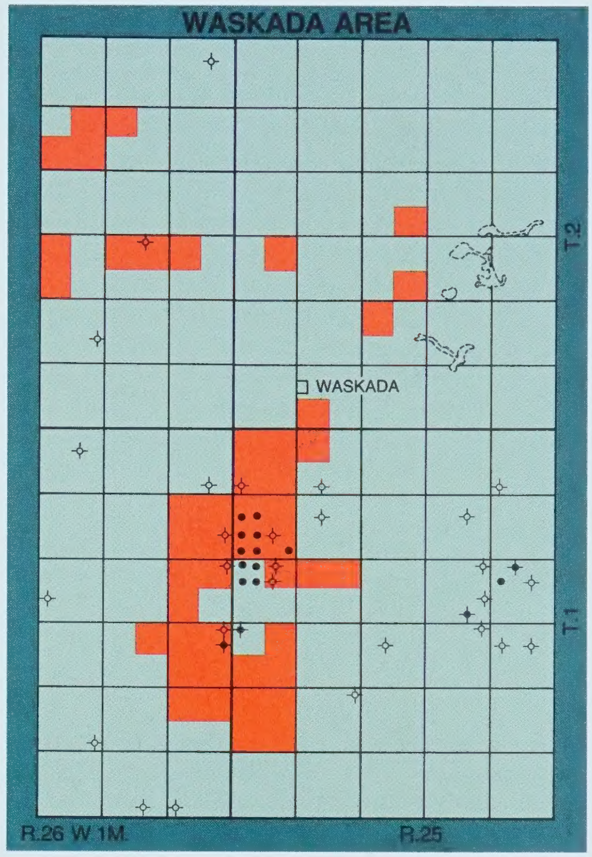
Omega Hydrocarbons Ltd. has varying interests in 10,720 acres of leases in Twps. 35 and 36, Rge. 8, West of the 4th Meridian, Alberta. During 1978, the Company completed 6 oil wells and 1 gas well on these properties as a follow-up to successfully re-completing and testing two shut-in gas wells in late 1977.

Three individual Viking sands, each having its own distribution pattern, are productive of oil and gas in this area. Where all three sands are present, the aggregate thickness of sand can be as much as 40 feet with net pays approaching 15 feet.

Initial production has been variable depending upon pay thickness and completion techniques but some of the wells have pumped at an initial rate of 60 barrels of oil per day. From the experience of other operators in the area, it appears that the reservoir will respond well to water-flood. The Company plans to drill a number of wells and commence a pilot water-flood project on these lands in 1979.

OIL WELL
GAS WELL
ABANDONED
OMEGA GAS GATHERING SYSTEM

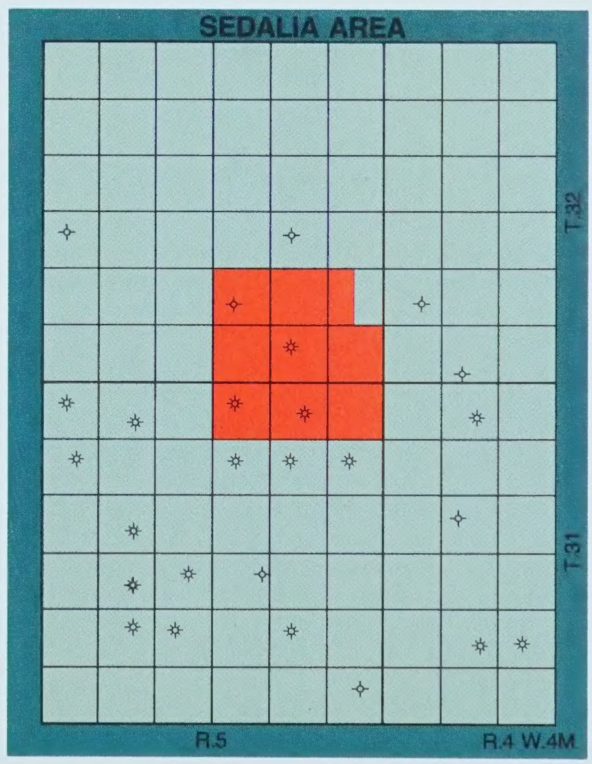




WASKADA

Omega has varying interests in a total of 7,520 acres in the Waskada area of southwest Manitoba where an oil accumulation was discovered by the Company some twelve years ago. Declining production caused the Company to initiate a water-flood program during 1976. Initial results were impressive and it now appears that some infill drilling will be necessary for overall performance.

Over the past year, Omega has increased its acreage holdings in the south Waskada area by the acquisition of a number of freehold leases. The Company has plans for exploratory drilling in this area during the second half of 1979. This play is an oil prospect which could easily double the Company's production from this area.



SEDALIA

Omega owns 5,440 acres of lands on the north end of the Sedalia field. Two gas wells were placed on stream some years ago and in 1978, another well was drilled to maintain deliverability and to satisfy provisions of the gas purchase contract. The gas is processed through a nearby plant in which Omega owns a 19.1% interest.

BITTERN LAKE

The Company has accumulated a substantial block of land in the Bittern Lake area of Alberta where an interesting oil prospect has been mapped. Land holdings consist of freehold parcels and Crown acquisitions including provisions to earn additional lands through farmout agreements. A location is staked and drilling will commence immediately after road bans are lifted.

BOW ISLAND

Omega holds various interests in a total of 10,240 acres in an area prospective for Cretaceous and Jurassic oil. In the fall of 1978, Omega and partners conducted a seismic program over a portion of the lands under the terms of a seismic option. As a result of this survey, the option was exercised and a commitment to drill a Mississippian test was made to earn an additional interest. This very interesting wildcat will be drilled during the early summer of 1979.

REDLANDS

Two dual zone gas wells were drilled on a 3,200 acre block of Crown leases during July and August, 1978. The producing horizons appear to be similar and possibly connected to the extensive Wayne Rosedale accumulation. The wells are presently shut-in awaiting a market.

The gas reserve is contracted to Pan Alberta Gas Ltd. and, assuming that an export permit will be issued before year end, Omega could be requested to start deliveries of between two and three million cubic feet per day by November of 1980.

WEST PEMBINA

The Company participated in the drilling of a Nisku project on the west side of the Pembina field during the summer of 1978. Although production was not established from the primary objective, the well was plugged back and completed as a Basal Cretaceous oil well. The well is presently undergoing production tests to determine the capability of the reservoir. Oil production from the well enjoys a five year royalty free holiday, accompanied by a corresponding federal tax benefit.

REVIEW OF OPERATIONS

PRODUCTION

Considering the curtailment of gas purchases by TransCanada Pipelines, production at Sedalia showed an increase of twenty-two percent over the previous year. The increase was made possible by maximizing deliverability from the producing wells. A new well, drilled and placed on production at year end, will serve to provide additional sales during the current year.

Oil production suffered a decline at Waskada, Manitoba and to a lesser degree at Willmar, Saskatchewan. Infill wells are now being considered at both locations as a means for reversing that trend. In addition, it is anticipated that the new wells placed on production at Provost during November of 1978 and new wells programmed for the current summer drilling season will overshadow any further decline from the older pools.

DRILLING

Your Company experienced a banner year in drilling activity surpassing any previous year in the Company's history. This resulted from the successful employment of drilling funds raised at the beginning of the year. Although drilling equipment was in short supply, Omega was successful in drilling fourteen wells including one re-entry of an old abandoned well. This program yielded eight oil wells, four gas wells and two abandonments. In addition, one wildcat well was drilled on farmout lands and subsequently abandoned at no cost to Omega.

Assuming a favorable financial climate, 1979 will see another big increase in drilling activity as development takes place in the Provost and Boyer fields of Alberta, along with a number of exploratory wildcat wells to be drilled.

LAND HOLDINGS

Company management is especially pleased to see the results of an aggressive land acquisition policy formulated in 1976.

That policy amounted to an active program of acquiring land at minimum cost to the Company. Year end holdings show approximately one hundred thousand net acres, most of which extends over the plains area of Alberta. This is an increase of some fifty-two thousand acres over 1977 year end. One of the most exciting acquisitions undertaken during the year was the purchase of 26,880 acres of petroleum and natural gas leases at Boyer, Alberta which includes the natural gas rights to a large shallow gas reservoir extending over the entire forty-two section block. Three other areas of sizeable land holdings having considerable potential are located in Provost, Westlock and Waskada.

The Company intends to continue its vigorous land acquisition policy, concentrating on special areas of interest where drilling prospects can be initiated without delay.

RESERVES

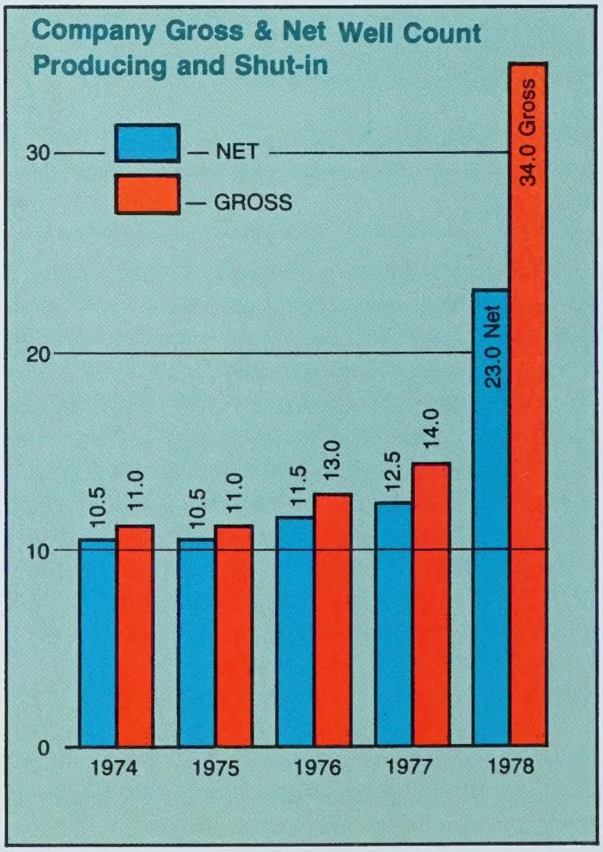
The past year recorded a dramatic increase in the Company's reserves of oil and gas. Net oil reserves more than doubled whereas net gas reserves increased more than five fold. At year end, Omega's net oil and gas reserves were estimated by the Company's technical staff to be 1,081,000 Bbls. and 37.0 Bcf respectively.

Proved and Probable Oil and Gas Reserves (Per Company's Internal Estimates) as of March, 1979

	1977	1978	Gain
Gross Oil S.T. Bbls.	844,300	1,739,000	894,700
Net Oil S.T. Bbls.	477,100	1,081,000	603,900
Gross Gas MMcf	11,750	57,261	45,511
Net Gas MMcf	6,530	36,958	30,428

Land Holdings (acres)

	Gross	Net
Alberta	104,241	86,207
Manitoba	12,825	9,185
Saskatchewan	4,315	4,235
Total	121,381	99,627



OMEGA HYDROCARBONS LTD.

CONSOLIDATED STATEMENT OF EARNINGS AND DEFICIT
YEAR ENDED DECEMBER 31, 1978

	1978	1977
REVENUE		
Oil and gas sales, net of royalties	$ 487,522	$ 612,860
Interest income	29,012	14,228
Other oil and gas operations	161,386	—
	677,920	627,088
EXPENSES		
Production	114,214	98,137
General and administrative	92,798	66,414
Interest and expense on long-term debt	7,973	9,542
Depletion	58,800	50,000
Depreciation	18,717	21,000
	292,502	245,093
Earnings before income taxes and extraordinary items	385,418	381,995
INCOME TAXES		
Deferred	165,600	175,000
Alberta Royalty Tax Credit	(35,018)	(34,900)
	130,582	140,100
Earnings before extraordinary items	254,836	241,895
EXTRAORDINARY ITEMS		
Gain on repurchase of 9% debentures	—	500
Recovery of deferred income taxes	13,600	175,000
	13,600	175,500
NET EARNINGS	268,436	417,395
Deficit at beginning of year	(1,012,739)	(1,430,134)
DEFICIT AT END OF YEAR	$ (744,303)	$(1,012,739)
EARNINGS PER SHARE, based on weighted average number of shares outstanding		
Earnings before extraordinary items	$.08	$.08
Net earnings	$.09	$.14

OMEGA HYDROCARBONS LTD.

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1978

ASSETS

	1978	1977
CURRENT ASSETS		
Cash and short-term deposits	$ 52,079	$ 80,000
Accounts receivable	930,048	140,573
Income taxes recoverable	34,782	34,900
Current portion of notes receivable (note 2)	52,833	28,333
	1,069,742	283,806
NOTES RECEIVABLE (note 2)	77,335	56,667
FIXED ASSETS		
Petroleum and natural gas leases and rights together with exploration, development and equipment thereon, at cost	2,539,749	1,411,468
Accumulated depletion and depreciation	(761,035)	(683,518)
	1,778,714	727,950
OTHER ASSETS		
Debenture issue expenses	—	3,552
Drilling and other deposits	24,512	24,512
	24,512	28,064
	$2,950,303	$1,096,487

OMEGA HYDROCARBONS LTD.

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1978

LIABILITIES

	1978	1977
CURRENT LIABILITIES		
Bank operating loan, secured	$ 117,316	$ 41,242
Accounts payable	1,058,882	76,023
	1,176,198	117,265
BANK PRODUCTION LOAN (note 3)	300,000	—
9% CONVERTIBLE DEBENTURES	—	93,000
DEFERRED GAS REVENUE	50,447	—
DEFERRED INCOME TAXES	152,000	—

SHAREHOLDERS' EQUITY

	1978	1977
CAPITAL STOCK (note 4)		
Authorized		
5,000,000 common shares of no par value		
Issued		
3,083,906 (1977 — 3,032,156) shares	2,015,961	1,898,961
DEFICIT	(744,303)	(1,012,739)
	1,271,658	886,222
	$2,950,303	$1,096,487

Approved by the Board:

Director

Director

OMEGA HYDROCARBONS LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED DECEMBER 31, 1978

	1978	1977
WORKING CAPITAL DERIVED FROM		
Operations		
Earnings before extraordinary items	$ 254,836	$241,895
Items not involving working capital		
Depletion	58,800	50,000
Depreciation	18,717	21,000
Amortization of debenture issue expenses	3,552	1,015
Deferred income taxes	165,600	175,000
	501,505	488,910
Bank production loan	300,000	—
Issue of common shares (note 4)	117,000	85,000
Deferred gas revenue	50,447	—
	968,952	573,910
WORKING CAPITAL APPLIED TO		
Notes receivable	20,668	56,667
Fixed assets	1,128,281	545,703
Drilling deposits	—	5,000
Debentures — converted	43,500	—
— retired	49,500	1,500
	1,241,949	608,870
DECREASE IN WORKING CAPITAL	(272,997)	(34,960)
Working capital at beginning of year	166,541	201,501
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ (106,456)	$166,541

OMEGA HYDROCARBONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 1978

1. ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Omega Oil & Gas Ltd.

(b) Oil and Gas Operations

The Company follows the full cost method of accounting for costs related to the exploration and development of petroleum and natural gas properties. Such costs, including production equipment, are accumulated on an area of interest basis and are amortized on the unit of production method based on estimated recoverable oil and gas reserves in each area or are written off to income if exploration activities in an area are determined to be unsuccessful.

(c) Income Taxes

The Company follows the tax allocation method of accounting under which the income tax provision is based on the earnings reported in its accounts. Under this method, the Company provides for deferred income taxes to the extent that income taxes otherwise payable are eliminated by claiming capital cost allowances and exploration and development costs in excess of the depreciation and depletion provisions reflected its accounts.

(d) Joint Ventures

Substantially all the Company's exploration and development activities related to oil and gas, are conducted jointly with others and accordingly, the accounts reflect only the Company's proportionate interest in such activities.

(e) Comparative Figures

Certain 1977 comparative figures have been reclassified to conform with the 1978 financial statement presentation.

2. NOTES RECEIVABLE

The notes receivable due from officers and employees are non-interest bearing and payable as follows:

1979 — $52,833
1980 — 52,835
1981 — 24,500

3. BANK PRODUCTION LOAN

The bank production loan is evidenced by a demand promissory note, bears interest at 1% above the bank's prime lending rate and is secured by the Company's interest in certain petroleum and natural gas properties and a general assignment of accounts receivable. The loan is repayable out of future production proceeds and accordingly, is not expected to require the use of existing working capital; therefore, no portion of the loan has been reclassified to current liabilities. The estimated amount of bank loan repayments for the five years subsequent to December 31, 1978 are $60,000 per year.

4. CAPITAL STOCK

(a) During 1978 the Company issued (i) 30,000 common shares to an employee for promissory notes totalling $73,500, on exercise of rights granted in November, 1976 under the Company's "Share Purchase Plan", and (ii) 21,750 common shares on conversion of $43,500 principal amount of 9% debentures.

(b) As of December 31, 1978, 100,000 common shares were reserved under the Company's "Share Purchase Plan" for issue to officers and employees from time to time as determined by the directors of the Company.

Changes during 1978 in the number of common shares reserved for issuance were as follows:

Shares reserved at beginning of year	676,500
Shares issued under "Share Purchase Plan"	(30,000)
9% Convertible debentures	
— converted	(21,750)
— retired	(24,750)
Termination of "drilling fund" share option agreement	(500,000)
Shares reserved at end of year	100,000

5. STATUTORY INFORMATION

Remuneration paid to directors and senior officers (including all employees) of the Company during 1978 amounted to $83,381.

AUDITORS' REPORT

To the Shareholders of
Omega Hydrocarbons Ltd.

We have examined the consolidated balance sheet of Omega Hydrocarbons Ltd. as at December 31, 1978 and the consolidated statements of earnings and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
March 23, 1979

THORNE RIDDELL & CO.
Chartered Accountants

graphics western limited
CANADA